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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Commission Requirements for	)	
Cost Support Material to be	)	CC Docket No. 92-91
Filed with Open Network	)	
Architecture Access Tariffs	)	

Comments on Direct Cases

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Comments on Direct Cases

Metromedia Communications Corporation ("Metromedia") by its attorneys and pursuant to the Commission's orders in this investigation,[1/] hereby submits its comments on the direct cases of the Bell Operating Companies ("BOCs"), the cost-support materials and models associated with those direct cases and the adequacy of the review of the cost models afforded the intervenors.

1/ In the Matter of Open Network Architecture Tariffs of Bell Operating Companies, Order Designating Issues For Investigation, CC Dkt. No. 92-91 (rel. Apr. 16, 1992) ("Designation Order"); In the Matter of Commission Requirements for Cost Support Materials to be Filed with Open Network Architecture Access Tariffs, Memorandum Opinion and Order, CC Dkt. No. 92-91 (rel. Aug. 14, 1992).

Summary

In its Part 69 ONA Order, the Commission directed the BOCs to file tariffs on or before November 1, 1991 to implement Open Network Architecture ("ONA") plans and to provide initial ONA service offerings.[2/] The tariffs filed pursuant to the Part 69 ONA Order set forth ONA service offerings and tariffed rates. Metromedia, along with other interested parties reviewed these tariff filings and discovered that the service offerings and rates lacked uniformity and did not appear consistent with the directions of the Commission in this proceeding. Metromedia remains concerned that the cost support materials that have been submitted by the BOCs for review by interested parties are indadequate, misleading and fail to justify the wide variation in rates between the BOCs' tariffs.

In the following Comments on Direct Cases, Metromedia discusses the failure of the BOCs to justify the rates in the tariffs and comments on the inadequacy of the process for review of the cost support materials and costing models associated with the tariffs. In addition, Metromedia points out the weaknesses in the independent audit of the switching

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2/ In the Matter of Amendments of Part 69 of the Commission's Rules Relating to the Creation Access Charge Subelements for Open Network Architecture, 6 FCC Rcd 4524, 4537 (1991) ("Part 69 ONA Order").

cost models conducted by Arthur Anderson. Metromedia concludes that the ONA tariff process cannot continue without specific guidance from the Commission regarding the costing methodologies and review procedures applicable to the tariffs and the cost support materials underlying those tariffs.

I. Introduction

Metromedia, in its Petition to Reject or in the Alternative to Suspend and Investigate the Open Network Architecture Tariff ("ONA Tariff") filings, detailed its objections to the Basic Service Element ("BSE") rates and clearly demonstrated that such rates are unreasonably discriminatory and fail to comply with the Commission's Rules, Regulations and Orders.[3/] Since the Metromedia Petition filing, Metromedia has reviewed the cost justification materials and costing models provided by the BOCs in support of the ONA Tariffs and remains convinced that the prices set forth in the the ONA Tariffs for individual BSEs bear no rational relationship to the cost of providing such service elements.

Only through the establishment of clear standards applicable to all BOCs and all ONA services can the Commission

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3/ See Petition to Reject or in the Alternative Suspend and Investigate, filed by Metromedia, November 22, 1991 ("Metromedia Petition").

reduce the BOCs' incentive to manipulate the allocation of costs among such features and to use varying and unreasonable costing methodologies to "justify" huge disparities between unit costs and rates. In addition, the Commission must allow interested parties to review and analyze the data inputs and processes that form the bases for BSE costs and rates. In other words, the redactions to the Switching Cost Information System ("SCIS") and the Switching Cost Module ("SCM") prevented any meaningful review in this proceeding. The Commission must also develop a procedure for reviewing changes to any approved costing methodology, and must provide a mechanism for ongoing review of such changes by interested parties to enable them to comment on such changes.

II. The Responses Of The BOCs In Their Direct Cases Fail To Justify The Non-Uniform Approach To Determining BSE Costs And Costing Models Employed By The BOCs

In the Designation Order, the Commission directed the BOCs to respond to several questions raised by the "wide disparity in rate levels of the BSEs among the BOCs."[4/] In response, the BOCs have argued that their costing methodologies, developed to identify direct costs and set price floors for their BSEs, are reasonable and consistent with the Commission's

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4/ Designation Order at 1.

ONA requirements.[5/] To the contrary, the direct cases filed by the BOCs in response to that directive fail to demonstrate any reasonable justification for the arbitrary differences between the unit cost values and rates presented by each BOC. For example, while the BOCs acknowledge that SCIS and SCM are designed to calculate forward-looking investment associated with the components of network switches to be used to provide BSEs,[6/] the majority of the BOCs include costs for analog equipment in their cost inputs.[7/] Such inclusion not only ignores the rapid and on-going change from analog to digital switches,[8/] but it unreasonably increases the unit costs applicable to the BSEs because analog equipment is more costly

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5/ See, e.g., Direct Case of BellSouth Telecommunications, Inc., at 2.

6/ See, e.g., Direct Case of Bell Atlantic at 1.

7/ See e.g., Direct Case of the Ameritech Operating Companies ("Ameritech Direct Case") at 5.

8/ Ameritech, in its Direct Case, acknowledges that "these offices are being replaced by digital machines as it becomes economic to do so." Id. As a result, basing BSE prices on old, expensive technology will undoubtedly lead to overinflated BSE prices and increased, unjustified revenues for the BOCs.

and less efficient, particularly on a going-forward basis.[9/] In effect, the BOCs are ignoring the underlying goals of ONA and are simply attempting to maximize their ability to overstate the investment needed to support unbundling and thereby to earn an unreasonable return on such investment.

The unbundling of Automatic Number Identification ("ANI") is of most immediate concern to Metromedia. ANI provides the telephone number of the call originator. Thus, ANI permits Metromedia, and for that matter, all other carriers, to

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9/ Ameritech goes so far as to state that there is no direct relationship between the four pricing goals of ONA and the decision to include analog equipment in investment costs. Ameritech Direct Case at 6. In the Designation Order, the Commission directed the BOCs to demonstrate (i) how BOC flexibility to price efficiently is furthered by the assumption by the embedded switch technology; (ii) how BOC incentives to innovate are fostered by reliance on the embedded technology assumption; (iii) how reliance on embedded technology costs fosters the Commission's stated goal that BOCs not set rates excessively high; and (iv) how reliance on embedded technology furthers the goal that BOCs not engage in unreasonably discriminatory pricing, Designation Order, at 3 quoting Part 69 ONA Order, 6 FCC rcd at 4531, para. 38. Ameritech's position that there is no direct relationship between the four pricing goals seems disingenuous at best. The Part 69 ONA Order clearly sets forth forward-looking goals which were intended to ensure a valid basis for the pricing of ONA features in the long term. Certainly, inclusion of obsolete equipment in the assumptions behind the ONA Tariffs is likely to skew the cost estimates underlying the initial ONA rates. If such cost estimates are skewed, there is a strong likelihood that the rates set by the BOCs will be excessively high if not unreasonably discriminatory.

determine the calling party which, in turn, permits Metromedia to determine the type of service subscribed to by that calling party and who to bill for that service. The choice of costing methodology and the overhead loading associated with this BSE, therefore, will have a dramatic effect on the ability of companies such as Metromedia to benefit from the ONA process. However, the choice of average costing rather than marginal costing, both of which are available under the SCIS model, and the disproportionate loading of overhead costs to ANI, will lead to ANI rates that are not truly cost-based and fail to serve the goals of ONA.

Because the Commission has not adopted a uniform standard for the costing methodology to be used in setting rates for ONA services and for calculating overhead loadings and direct costs, the BOCs have crafted their own divergent methodologies.[10/] The amount of flexibility given to the BOCs by the use of such divergent methodologies allows them to develop rates that, in some cases, are many times more than the rates charged for the identical ONA services of the other

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10/ See e.g., US West Direct Case at p. 7-8 where it states that it can "only surmise from Attachment A in the Commission's Designation Order that BellSouth and US West use significantly different methodologies for calculating overhead loadings, and possibly for calculating direct costs than other Bell Operating Companies . . ."

BOCs.[11/] Clearly, the Commission cannot sanction such results without compiling a record that demonstrates the reasonableness of such divergent rates with meaningful input from interested parties.[12/]

With regard to overhead loadings applicable to BSEs such as ANI, US West argues that, despite its high overhead loadings, its overall prices for ONA services are reasonable and that the overall reasonableness of its rates simply suggests different pricing methodologies rather than excessive overhead loadings. This argument is patently ridiculous. US West does not even attempt to cost-justify its excessive overhead loadings. The overall reasonableness of a rate cannot be used to justify the reasonableness of any component part of that rate. In fact, if any individual component of a rate is unreasonable, the overall reasonableness of the rate must be suspect. Such logical inconsistencies cannot be accepted by the Commission as a basis for approving tariffed rates.

11/ See Metromedia Petition at 24.

12/ As the Commission recently restated, uniformity in costing practices is important to guard against improprieties in cost accounting processes. In the Matter of Implementation of Further Cost Allocation Uniformity, Order Inviting Comments, AAD 92-42 (Rel. Oct. 15, 1992) citing Computer III Remand Proceedings: Bell Operating Company Safeguards and Tier I Local Exchange Company Safeguards, Report and Order, 6 FCC Rcd 7571 (1991).

Nevada Bell, on the other hand, admits that the cost of providing ANI is so low that it raised the ANI price to a level adequate to "lower the unbundled local switching rates and achieve revenue neutrality."[13/] Obviously, this type of rate manipulation is anathema to the principles underlying ONA and should also be rejected by the Commission.

To accept the rates as filed given the conflicting and inadequate justification for those rates would establish an inequitable precedent enabling the BOCs to manipulate the allocation of costs and the resulting rates to suit their own goals of monopoly profits rather than the stated pro-competitive goals of the Commission in this proceeding.

III. The Review Of The SCIS And SCM Models Afforded The Intervenors Was Inadequate To Facilitate Meaningful Comment On The Adequacy Of The Models And Must Be Improved To Ensure That Ongoing Review Of The ONA Tariff Process Protects All Interested Parties

The primary purpose for reviewing costing models such as SCIS and SCM is to ensure that rational costing principles have been consistently applied. Metromedia, in conducting its review, attempted to answer the four following questions:

1. Did the BOC in question apply costing principles and assumptions consistently across all ONA features?

13/ Direct Case of Nevada Bell at 4.

2. Were costs estimated for relevant samples of switches?

3. Did the underlying switch prices/discounts accurately reflect the switch prices/discounts paid by the BOC?

4. Did the network parameters used to estimate cost relationships such as traffic loads, peak to busy hour, generic software loads, etc., accurately reflect the BOC's network?

Under the review process employed in this proceeding, Metromedia was unfortunately not able to answer any of these questions completely. Yet, without such answers, it is impossible to determine whether the underlying costs and resulting rates are reasonable.

The SCIS costing model is based on "cost primitives." The model estimates the cost of the various switching primitives associated with the provision of BSEs and then calculates the cost of the service element by determining the quantity of each primitive used to provide each BSE. The SCIS models provided to the intervenors, however, redacted all of the intermediate cost primitive calculations. As a result, it was impossible for Metromedia to determine if the same value for a particular cost primitive was used for each unbundled feature. In addition, it was impossible to determine whether the value assigned to each cost primitive was valid.

Without access to the intermediate cost primitive calculations, intervenors have no way to evaluate whether the cost primitives or the resulting rates are reasonable. Until intervenors are given access to cost primitives, the record in this proceeding will be incomplete because intervenors will have had no meaningful ability to evaluate and comment upon the validity of the stated costs underlying the rates in question.

Furthermore, there is currently no uniform requirement relating to the selection of switches included in the sample used by each BOC to estimate the investment underlying the provision of ONA services. The age of the sample switch data also affects the mix of switching equipment and the cost of providing switching services which are reflected in the resulting BSE rates. Such discretion leaves open the opportunity for a BOC to strategically select switches in such a fashion that the cost of providing services is maximized. Whether the sampling is random, representative or elective, the possibility for an accurate result is remote. The only solution to the problem of switch selection is to establish a uniform standard for selecting switches for the model. Ideally, of course, all switches should be included.

In addition, the underlying switch prices and any discounts available to the BOCs must be made available to the intervenors, or at the very least, the data inputs used for these costs should be subject to an independent audit.[14/] Such an independent audit would also be necessary to determine whether the network parameters used to estimate the cost relationships which determine the cost outputs accurately reflect the reality of the BOCs' networks.

The different versions of the SCIS model used by different intervenors only serves to exacerbate the inability to accurately reflect the relationship between network parameters and the resulting cost figures. Stated differently, allowing the BOCs to use different versions of the SCIS model without an adequate explanation as to the type and degree of such variation makes it impossible to judge which, if any, of the versions of SCIS provide accurate cost estimates.

To add to the confusion, the US West SCM model does not conform to the SCIS format and presumably does not parallel the SCIS models. While this variation would not be cause for great concern where the Commission had established clear costing methodology standards, and where intervenors had adequate access to the models and associated inputs, that is not the case in this proceeding. Therefore, the Commission must reconcile the use of these different methodologies or face the

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14/ These inputs were not subject to the independent audit conducted by Arthur Anderson in this proceeding.

prospect that the results obtained from the two types of models may diverge greatly both now and in the future as additional ONA services are introduced.

IV. The Independent Audit Conducted by Arthur Anderson did not Accurately Disclose the Relative Importance of the Variables Included in the Costing Models Used by the BOCs

While the Arthur Anderson independent auditor's report provided some helpful information regarding the SCIS and SCM models, apparently Arthur Anderson was unable to disclose which cost primitives or other factors drive the wide variation in rates for the BSEs included in the ONA Tariffs. The impact of different types of switch software was not broken out from the impact of costing model software leaving Metromedia to guess which software was driving changes in results. In addition, the audit focused on variation in results rather than absolute or percentage change in each individual BOC's result, based on "average" or "consensus values" which may have masked the relative importance of various discretionary inputs. Moreover, the comparison of average versus marginal costing methodologies appeared to ignore the fact that seven of the nine BOCs had already used the average cost routine. Hence, the report may have hidden as much information as it provided.

V. Conclusion

In the Part 69 ONA Order, the Commission amended its Part 69 Access Rules to enable the BOCs to offer ONA services on an unbundled basis. This process was intended to complement the Commission's efforts to promote full and fair inter-exchange competition and to remove barriers that currently impede the development of greater competition in the provision of interstate access transmission facilities.[15/]

In order to meet those stated goals, the Commission must ensure that the rates charged for the unbundled ONA services are rationally related to the cost of providing those individual services and are reasonable. Unless the Commission establishes specific standards for the costing methodology to be employed by the BOCs and provides for meaningful access to the "cost primitive" data and the inputs utilized by the BOCs, the goal of deriving rates for unbundled services from the cost of providing each component part of such service will be frustrated. Furthermore, if the BOCs are allowed to take a "top down" approach to allocating all of the costs associated with their businesses to the provision of these few services,

15/ See In The Matter of Filing and Review of Open Network Architecture plans, 4 FCC Rcd 1 (1988), recon. denied, 5 FCC Rcd 3084 (1990); Filing and Review of Open Network Architecture Plans, 5 FCC Rcd 3103 (1990).

the result will be marked increases in the costs of access services and the stifling of competition in the provision of interstate access transmission facilities.

The Commission cannot allow the BOCs unbriddled discretion to choose the configuration and functions of the cost models used to determine unbundled service rates. The BOCs should be required to justify the rate for each BSE on an incremental cost basis. This is the only way to insure that the BOCs are not able to allocate costs in a way that double counts costs and overloads overhead onto particular BSEs.

Metromedia has no desire to deprive the BOCs of a reasonable return on the legitimate investment necessary to fulfill their obligations under the ONA process. However, the arguments made by the BOCs that investors need exorbitant rates of return to justify the additional risks introduced into their businesses because of ONA are unwarranted and such excessive rates of return should not be financed by the consumers of ONA services.

The ultimate goal of the ONA process is the promotion of competition. Providing an unfair advantage to the BOCs through the ONA tariff process will only stifle competition. Therefore, the Commission must establish clear standards to guide the process by which the BOCs determine rates for unbundled services and must insure that the intervenors have an adequate opportunity to review the cost justification materials submitted by the BOCs both now and in the future.

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<u>CERTIFICATE OF SERVICE</u>

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